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C O N F I D E N T I A L SECTION 01 OF 02 BEIJING 002658

SIPDIS

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TAGS: ETRD EINV PREL EMIN CH AS

SUBJECT: RIO-TINTO UPDATES AMBASSADOR ON STERN HU ARREST

REF: (A) BEIJING 1966 AND PREVIOUS (B) SHANGHAI 321  
(C) CANBERRA 621 AND PREVIOUS

BEIJING 00002658 001.2 OF 002

Classified By: Economic Minister Counselor William Weinstein. Reasons 1.4 (b, d)

¶1. (C) Summary: Rio Tinto Iron Ore (Rio) has quietly reopened negotiations with Chinalco as part of an effort to win the release of its employee and Australian national Stern Hu. In response to Hu's arrest and to avoid further accusations of stealing secrets, Rio is considering transferring all of its decision-makers out of China. Rio's internal investigations have uncovered no evidence of employees stealing secrets but have found two employees holding relatively small amounts of money from sources they cannot verify. The Ambassador agreed to discuss with the Australian Ambassador how best to urge China to handle the Hu arrest and other commercial cases fairly and transparently. End summary.

¶2. (C) The Ambassador met on September 15 with Rio Tinto Iron Ore's Managing Director for Sales and Marketing Ian Bauert and Kennecott Utah Copper's CEO Andrew Harding. Australia-based Rio Tinto Iron Ore (Rio) and U.S.-based Kennecott Utah Copper are both subsidiaries of the UK conglomerate Rio Tinto.

¶3. (C) Bauert said he visited Stern Hu in prison the week of August 31. Hu was in fine physical shape, but he was much worse emotionally than during previous visits. Hu complained that his arrest was politically motivated, inspired by the failed Rio-Chinalco deal, iron ore price negotiations, and a recently announced BHP-Rio joint production deal.

¶4. (C) The PRC has not formally charged Hu, Bauert noted. Press reports indicate that the original charge of espionage had first been reduced to obtaining state secrets illegally, which in turn was reduced to obtaining commercial secrets illegally. The basis for this charge also morphed from attempting to bribe state-owned steel mill employees to receiving bribes from private steel mill employees. Rio has not seen any evidence to substantiate these charges. Though changed, both remaining charges are still serious.

¶5. (C) Rio has not had access to any evidence compiled by the PRC, Bauert said. The company has launched an internal investigation to uncover any possible illegal activity within the company. Although the investigation has confirmed that all information gathered by Rio employees was from publicly available sources, there are two anomalies that the Rio investigators are looking at more closely. One employee received "dividends" of up to 20,000 Australian dollars (USD 15,000) from private steel mills in China. The money appears to have been freely given, but the company is conducting

further checks on the source. Separately, Rio officials found RMB 30,000 (USD 4,400) in the room of an arrested employee that had already been searched and sealed by PRC authorities. Rio reported this finding to the Public Security Bureau and is continuing its internal investigation.

16. (C) The Hu arrest has significantly affected how Rio conducts business here, Bauert emphasized. The company is planning to move all of its decision-makers out of the country, leaving only contract, shipping, and other day-to-day work for employees in China. One Chinese-born American citizen manager has refused to move forward with a planned transfer to Shanghai for fear of his safety. Other companies, including Caterpillar, have said that they, too, are rethinking how they do business in China.

17. (C) Rio is asking the Australian, U.S., UK, and other embassies to put pressure on PRC authorities. Rio has also reopened talks with Chinalco on possible cooperative ventures, but not on the same scale as the USD 19 billion deal that Rio shareholders rejected earlier this year. Rio's goal is to create an environment in which senior PRC officials feel they can release Hu without losing face.

18. (C) The Ambassador recommended Rio managers continue to raise their concerns at the highest levels in the PRC, and said he would consult this week with the Australian Ambassador to determine what we can do together on the Hu case specifically and on rule of law in China more broadly.

19. (C) Comment: Regardless of whether Stern Hu is simply a victim of political revenge (the Rio version of events) or was involved in illegal business practices (as alleged by PRC

BEIJING 00002658 002.2 OF 002

authorities), his arrest has already spooked at least a few major multinational corporations in China. Even though the state espionage charge against Hu has been dropped for now, the malleable definition of what constitutes a state secret has a potentially chilling effect on those doing business in China. In this regard, we hope to engage the Chinese on the recently submitted USG comments urging the National People's Congress to tighten and clarify the definition of state secrets as it works on amending the State Secrets Law. End comment.

HUNTSMAN